

# Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on the Amahlathi Local Municipality

## Report on the audit of the financial statements

### Qualified opinion

1. I have audited the financial statements of the Amahlathi Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2019, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion section of this auditor's report, the financial statements present fairly, in all material respects, the financial position of the Amahlathi Local Municipality as at 30 June 2019, and financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act no. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2018 (Act no.1 of 2018) (Dora).

### Basis for qualified opinion

#### Irregular expenditure

3. The municipality did not have adequate systems to identify and disclose all irregular expenditure during the year, as required by section 125(2)(d)(i) of the MFMA. The irregular expenditure of R73,1 million disclosed in note 44 to the financial statements was understated by R3,3 million, incurred during the year, that was identified during the audit process. The lack of sufficient appropriate audit evidence for all awards made it impracticable to determine the full extent of the understatement of irregular expenditure disclosed in the notes to the financial statements.

#### Expenditure: bulk purchases

4. I was unable to obtain sufficient appropriate audit evidence for bulk purchases, as internal controls had not been established for the monthly amounts billed by the electricity supplier. I could not confirm whether bulk purchases had been correctly recorded by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to bulk purchases of R29 million disclosed in note 31 to the financial statements and electrical distribution losses of R8,2 million disclosed in note 45 to the financial statements.

## **Expenditure: general expenses – free basic services**

5. The municipality paid for free basic services for consumers who are not listed on the indigent register. I was unable to determine the full extent of the overpayment of R9,4 million included in general expenses of R30,3 million, disclosed in note 33 to the financial statements, as it was impracticable to do so.

## **Context for the opinion**

6. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of this auditor's report.
7. I am independent of the municipality in accordance with sections 290 and 291 of the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants*, and parts 1 and 3 of the International Ethics Standards Board for Accountants' *International code of ethics for professional accountants (including International Independence Standards)* (IESBA codes), as well as the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA codes.
8. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

## **Material uncertainty relating to going concern**

9. I draw attention to the matters below. My opinion is not modified in respect of these matters.
10. As disclosed in note 41 to the financial statements, the municipality disclosed the following financial risks that have a negative impact on its ability to sustain its current level of operations in the near future, before taking into account government grants:
  - An ability to pay creditors within due dates
  - Negative key financial ratios
  - Net current liability was realised

In addition, the actions taken by management to mitigate the impact of these risks are disclosed in this note.

## **Emphasis of matters**

11. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Restatement of corresponding figures**

12. As disclosed in note 46 to the financial statements, the corresponding figures for 30 June 2018 were restated as a result of an error in the financial statements of the municipality at, and for the year ended, 30 June 2019.

### **Impairment loss on non-current assets**

13. As disclosed in the statement of performance, impairment loss on non-current assets of R39,2 million were incurred as a result of the fire that destroyed municipal buildings on 16 October 2018.

### **Material impairments consumer debtors and receivables from non-exchange transactions**

14. As disclosed in note 4 and 5, respectively, to the financial statements, material impairments for consumer debtors and other debtors of R26,8 million (2018: R21,9 million) and receivables from non-exchange transactions of R20,8 million (2018: R16,3 million) were incurred as a result of a poor collections.

### **Underspending of conditional grant**

15. As disclosed in note 18 to the financial statements, the municipality materially underspent the municipal infrastructure grant by R3,2 million.

### **Unauthorised expenditure**

16. As disclosed in note 42 to the financial statements, unauthorised expenditure of R100 million incurred in previous years was not investigated.

### **Fruitless and wasteful expenditure**

17. As disclosed in note 43 to the financial statements, fruitless and wasteful expenditure of R6,6 million incurred in previous years was not investigated.

### **Other matters**

18. I draw attention to the matter below. My opinion is not modified in respect of this matter.

### **Unaudited disclosure note**

19. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

### **Responsibilities of the accounting officer for the financial statements**

20. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA

and Dora, and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

21. In preparing the financial statements, the accounting officer is responsible for assessing the Amahlathi Local Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

### **Auditor-general's responsibilities for the audit of the financial statements**

22. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
23. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

## **Report on the audit of the annual performance report**

### **Introduction and scope**

24. In accordance with the Public Audit Act of South Africa, 2004 (Act no. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for the selected key performance area presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
25. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators /measures included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
26. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected key performance area

presented in the annual performance report of the municipality for the year ended 30 June 2019:

Key performance area	Pages in the annual performance report
KPA 1 – basic service delivery and infrastructure development	x – x

27. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
28. The material findings in respect of the reliability of the selected key performance area are as follows:

#### KPA 1 – basic service delivery and infrastructure development

29. I was unable to obtain sufficient appropriate evidence for the reported achievements listed in the table below. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievements by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement in the annual performance report of the indicators listed below:

Indicator number	Indicator	Target	Actual reported performance
1.3	% of potholes repaired as per departmental inspections	80% potholes repaired as per departmental inspections	Target met. 100% reported potholes that were repaired only in Q1.  There were no inspections done on other quarters due to financial constraints to repair them
1.18	No of households and businesses with basic waste collection	6 532 households and businesses with access to basic waste collected (ward 1, 4, 5, 6, 8, 13, 14, 15)	Target not met. 6 311 households and businesses with access to basic waste collected (wards 1, 4, 5, 6, 8, 13, 14, 15)



## **Other matters**

30. I draw attention to the matters below.

### **Achievement of planned targets**

31. Refer to the annual performance report on pages ... to ... for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on reliability of the reported performance information in paragraph 29 of this report.

### **Adjustment of material misstatements**

32. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of KPA 1: basic services and infrastructure development. As management subsequently corrected only some of the misstatements, I raised material findings on the reliability of the reported performance information. Those that were not corrected are reported above.

## **Report on the audit of compliance with legislation**

### **Introduction and scope**

33. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

34. The material findings on compliance with specific matters in key legislations are as follows:

### **Annual financial statements, annual performance report and annual report**

35. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of investment properties, property plant and equipment, payables, unauthorised expenditure, commitments and statement of comparison of budget and actual amounts identified by the auditor in the submitted financial statements were subsequently corrected and the supporting records were provided, but the uncorrected material misstatements or supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

36. The 2017-18 annual report was not tabled in the municipal council after the end of the financial year, as required by section 127(2) of the MFMA.

37. Sufficient appropriate audit evidence could not be submitted to confirm that the local community was invited to submit representations in connection with the 2017-18 annual report, as required by section 127(5)(a) of the MFMA.

38. The council failed to adopt an oversight report containing the council's comments on the annual report, within the prescribed timelines, as required by section 129(1) of the MFMA.

### **Consequence management**

39. Unauthorised expenditure by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.
40. Irregular and fruitless and wasteful expenditure by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

### **Procurement and contract management**

41. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded in accordance with the legislative requirements, as most of the documentation was destroyed in a fire that destroyed the municipal offices during October 2018.
42. Sufficient appropriate audit evidence could not be obtained that quotations were only accepted from bidders whose tax matters had been declared by the South African Revenue Service to be in order, as required by supply chain management (SCM) regulation 43.
43. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value above R500 000 were procured by inviting competitive bids and that deviations approved by the accounting officer were only if it was impractical to invite competitive bids, as required by SCM regulation 19(a).
44. Sufficient appropriate audit evidence could not be obtained that contracts were awarded only to bidders who submitted a declaration on whether they were employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

### **Expenditure management**

45. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The full extent of the irregular expenditure could not be quantified as indicated in the basis for qualification paragraph. Irregular expenditure of R12,8 million was incurred on the standardisation of salaries and R284 925 for not following the SCM processes.
46. Reasonable steps were not taken to prevent unauthorised expenditure of R81,3 million, as disclosed in note 42 to the financial statements, in contravention of section 62(1)(d) of the MFMA. Unauthorised expenditure was incurred on overspending vote 1 executive and council (R13,7 million), vote 2 budget and treasury office (R58,7 million), vote 3 corporate services (R2,6 million), vote 5 community and social services (R2,2 million), vote 7 public safety (R7 236), and vote 9 waste management (R4,7 million).

47. Reasonable steps were not taken to prevent fruitless and wasteful expenditure of R793 025, as disclosed in note 43 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by interest paid on overdue accounts.
48. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

#### Strategic planning and performance

49. The performance management system and related controls were not maintained as it did not describe how the performance planning, monitoring, measurement and reporting processes should be conducted and managed, as required by municipal planning and performance management regulation 7(1).
50. A mid-year performance assessment was not performed, as required by section 72(1)(a)(ii) of the MFMA.

#### Conditional grants

51. Performance in respect of programmes funded by the municipal infrastructure grant, expanded public works programme grant and integrated national electrification programme grant was not evaluated within two months after the end of the financial year, as required by section 12(5) of the Dora.

#### Other information

52. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report and the selected key performance area presented in the annual performance report that have been specifically reported in this auditor's report.
53. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
54. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected key performance area presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
55. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.



## Internal control deficiencies

56. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
- There was insufficient oversight to ensure consistent implementation and monitoring of controls over financial and performance information, and compliance with legislation. This was partly the result of a fire during October 2018 that destroyed the budget and treasury offices, which had a negative impact on the daily operations of the municipality. In addition there was ongoing instability in the council during the financial year under review.
  - The municipality did not have adequate systems in place to account for and record bulk purchases, irregular expenditure and payments made in respect of indigents who are not listed in the indigent register. This resulted in material findings on irregular expenditure, bulk purchases and free basic services in the financial statements.
  - Complete, accurate and reliable monthly and quarterly performance reports for the selected key performance area were not prepared, resulting in material findings raised on the selected key performance area. This was due to the standard operating procedures not being consistently applied by the responsible staff.
  - The municipality did not have adequate systems to monitor compliance with all applicable legislation and, as a result, non-compliance with legislation was not prevented. There was inadequate supervision, monitoring and consequence management in respect of managing of the operations of the municipality.
  - The internal audit unit did not perform all planned audits for the financial year. This was a result of the fire that destroyed municipal buildings during October 2018. As a result, the internal audit unit and audit committee were functional during the financial year under review but were not fully effective.

## Other reports

57. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.
58. The President of South Africa promulgated an investigation by the Special Investigating Unit (SIU) based on the allegation of possible procurement irregularities covering the period July 2013 to June 2014. This investigation was still in progress at the date of this report.

59. An independent consultant finalised a forensic investigation on possible irregularities in the traffic department covering the period 1 July 2014 to 30 June 2017, and possible procurement irregularities covering the period April 2015 to March 2016.
60. An inquiry by the Department of Cooperative Governance and Traditional Affairs (Cogta) into allegations of impropriety and irregularities in terms of section 105 of the Municipal Systems Act was finalised, and included the 2017-18 and 2018-19 financial years.
61. An independent firm was appointed by Cogta to investigate various allegations into procurement processes not followed from 2016 to date, and to investigate all personnel appointments from March 2016 to date. The investigation was still ongoing at the date of this report.

*Auditor-General*

East London

29 November 2019



## **Annexure – Auditor-general's responsibility for the audit**

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for the selected key performance area and on the municipality's compliance with respect to the selected subject matters.

### **Financial statements**

2. In addition to my responsibility for the audit of the financial statements as described in this auditor's report, I also:
  - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
  - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control
  - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
  - conclude on the appropriateness of the accounting officer's use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Amahlathi Local Municipality's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor's report. However, future events or conditions may cause a municipality to cease continuing as a going concern
  - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

### **Communication with those charged with governance**

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.